

NORTH ORANGE COUNTY COMMUNITY COLLEGE DISTRICT

Audit Report

HEALTH FEE ELIMINATION PROGRAM

Chapter 1, Statutes of 1984, Second Extraordinary Session;
and Chapter 1118, Statutes of 1987

July 1, 2007, through June 30, 2010



JOHN CHIANG
California State Controller

July 2013



JOHN CHIANG
California State Controller

July 22, 2013

Donna Miller, President
Board of Trustees
North Orange County Community College District
1830 W. Romneya Drive
Anaheim, CA 92801-1819

Dear Ms. Miller:

The State Controller's Office audited the costs claimed by the North Orange County Community College District for the legislatively mandated Health Fee Elimination Program (Chapter 1, Statutes of 1984, Second Extraordinary Session; and Chapter 1118, Statutes of 1987) for the period of July 1, 2007, through June 30, 2010.

The district claimed \$983,191 for the mandated program. Our audit found that \$575,479 is allowable and \$407,712 is unallowable primarily because the district overstated indirect costs, and understated authorized health service fees and offsetting savings/reimbursements. The State paid the district \$943,343. The State will offset \$367,864 from other mandated program payments due the district. Alternatively, the district may remit this amount to the State.

If you disagree with the audit findings, you may file an Incorrect Reduction Claim (IRC) with the Commission on State Mandates (CSM). The IRC must be filed within three years following the date that we notify you of a claim reduction. You may obtain IRC information at the CSM's website at www.csm.ca.gov/docs/IRCForm.pdf.

If you have any questions, please contact Jim L. Spano, Chief, Mandated Cost Audits Bureau, at (916) 323-5849.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/vb

cc: Ned Doffoney, Ph.D., Chancellor
North Orange County Community College District
Fred Williams, Vice Chancellor, Finance and Facilities
North Orange County Community College District
Rodrigo Garcia, CPA
Interim Director, Fiscal Affairs
North Orange County Community College District
Kashmira Vyas, CPA (Inactive)
Interim Manager, Fiscal Affairs
North Orange County Community College District
Christine Atalig, Specialist
College Finance and Facilities Planning
California Community Colleges Chancellor's Office
Mollie Quasebarth, Principal Program Budget Analyst
Education Systems Unit
California Department of Finance
Mario Rodriguez, Finance Budget Analyst
Education Systems Unit
California Department of Finance
Jay Lal, Manager
Division of Accounting and Reporting
State Controller's Office

Contents

Audit Report

Summary	1
Background	1
Objective, Scope, and Methodology	2
Conclusion	2
Views of Responsible Official	2
Restricted Use	3
Schedule 1—Summary of Program Costs	4
Findings and Recommendations	6
Attachment—District’s Response to Draft Audit Report	

Audit Report

Summary

The State Controller's Office (SCO) audited the costs claimed by the North Orange County Community College District for the legislatively mandated Health Fee Elimination Program (Chapter 1, Statutes of 1984, Second Extraordinary Session; and Chapter 1118, Statutes of 1987) for the period of July 1, 2007, through June 30, 2010.

The district claimed \$983,191 for the mandated program. Our audit found that \$575,479 is allowable, and \$407,712 is unallowable primarily because the district overstated indirect costs, and understated authorized health service fees and offsetting savings/reimbursements. The State paid the district \$943,343. The State will offset \$367,864 from other mandated program payments due the district. Alternatively, the district may remit this amount to the State.

Background

Chapter 1, Statutes of 1984, Second Extraordinary Session, repealed Education Code section 72246, which authorized community college districts to charge a health fee for providing health supervision and services, providing medical and hospitalization services, and operating student health centers. This statute also required that health services for which a community college district charged a fee during fiscal year (FY) 1983-84 had to be maintained at that level in FY 1984-85 and every year thereafter. The provisions of this statute would automatically sunset on December 31, 1987, reinstating the community college districts' authority to charge a health service fee as specified.

Chapter 1118, Statutes of 1987, amended Education Code section 72246 (subsequently renumbered as section 76355 by Chapter 8, Statutes of 1993). The law requires any community college district that provided health services in FY 1986-87 to maintain health services at the level provided during that year for FY 1987-88 and for each fiscal year thereafter.

On November 20, 1986, the Commission on State Mandates (CSM) determined that Chapter 1, Statutes of 1984, Second Extraordinary Session, imposed a "new program" upon community college districts by requiring specified community college districts that provided health services in FY 1983-84 to maintain health services at the level provided during that year for FY 1984-85 and for each fiscal year thereafter. This maintenance-of-effort requirement applied to all community college districts that levied a health service fee in FY 1983-84.

On April 27, 1989, the CSM determined that Chapter 1118, Statutes of 1987, amended this maintenance-of-effort requirement to apply to all community college districts that provided health services in FY 1986-87, requiring them to maintain that level in FY 1987-88 and for each fiscal year thereafter.

The program's parameters and guidelines establish the state mandate and define reimbursement criteria. The CSM adopted the parameters and guidelines on August 27, 1987, and amended them on May 25, 1989, and January 29, 2010. In compliance with Government Code section 17558, the SCO issues claiming instructions to assist school districts in claiming mandated program reimbursable costs.

Objective, Scope, and Methodology

We conducted the audit to determine whether costs claimed represent increased costs resulting from the Health Fee Elimination Program for the period of July 1, 2007, through June 30, 2010.

Our audit scope included, but was not limited to, determining whether costs claimed were supported by appropriate source documents, were not funded by another source, and were not unreasonable and/or excessive.

We conducted this performance audit under the authority of Government Code sections 12410, 17558.5, and 17561. We did not audit the district's financial statements. We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We limited our review of the district's internal controls to gaining an understanding of the transaction flow and claim preparation process as necessary to develop appropriate auditing procedures.

Conclusion

Our audit found instances of noncompliance with the requirements outlined above. These instances are described in the accompanying Summary of Program Costs (Schedule 1) and in the Findings and Recommendations section of this report.

For the audit period, the North Orange County Community College District claimed \$983,191 for costs of the Health Fee Elimination Program. Our audit found that \$575,479 is allowable and \$407,712 is unallowable. The State paid the district \$943,343. The State will offset \$367,864 from other mandated program payments due the district. Alternatively, the district may remit this amount to the State.

Views of Responsible Official

We issued a draft audit report on May 29, 2013. Fred Williams, Vice Chancellor, Finance and Facilities, responded by letter dated June 18, 2013 (Attachment) and agreed with, or declined to dispute, the audit results except for Findings 2 and 3. This final audit report includes the district's response.

Restricted Use

This report is solely for the information and use of the North Orange County Community College District, the California Community Colleges Chancellor's Office, the California Department of Finance, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

July 22, 2013

Schedule 1— Summary of Program Costs July 1, 2007, through June 30, 2010

Cost Elements	Actual Costs Claimed	Allowable per Audit	Audit Adjustment	Reference ¹
<u>July 1, 2007, through June 30, 2008</u>				
Direct costs:				
Salaries and benefits	\$ 956,757	\$ 985,511	\$ 28,754	Finding 1
Services and supplies	194,543	238,054	43,511	Finding 2
Total direct costs	1,151,300	1,223,565	72,265	
Indirect costs	337,854	350,349	12,495	Finding 3
Total direct and indirect costs	1,489,154	1,573,914	84,760	
Less authorized health service fees	(1,228,620)	(1,289,050)	(60,430)	Findings 4, 5
Less offsetting savings/reimbursements	—	(136,748)	(136,748)	Finding 6
Total program costs	\$ 260,534	148,116	\$ (112,418)	
Less amount paid by the State		(220,686)		
Allowable costs claimed in excess of (less than) amount paid		\$ (72,570)		
<u>July 1, 2008, through June 30, 2009</u>				
Direct costs:				
Salaries and benefits	\$ 1,021,552	\$ 1,065,543	\$ 43,991	Finding 1
Services and supplies	219,452	233,515	14,063	Finding 2
Total direct costs	1,241,004	1,299,058	58,054	
Indirect costs	459,669	404,800	(54,869)	Finding 3
Total direct and indirect costs	1,700,673	1,703,858	3,185	
Less authorized health service fees	(1,358,360)	(1,437,523)	(79,163)	Findings 4, 5
Less offsetting savings/reimbursements	—	(126,068)	(126,068)	Finding 6
Total program costs	\$ 342,313	140,267	\$ (202,046)	
Less amount paid by the State		(342,313)		
Allowable costs claimed in excess of (less than) amount paid		\$ (202,046)		
<u>July 1, 2009, through June 30, 2010</u>				
Direct costs:				
Salaries and benefits	\$ 1,152,005	\$ 1,152,005	\$ —	
Services and supplies	241,800	236,046	(5,754)	Finding 2
Total direct costs	1,393,805	1,388,051	(5,754)	
Indirect costs	544,699	443,292	(101,407)	Finding 3
Total direct and indirect costs	1,938,504	1,831,343	(107,161)	
Less authorized health service fees	(1,508,865)	(1,494,952)	13,913	Finding 5
Less offsetting savings/reimbursements	(49,295)	(49,295)	—	
Total program costs	\$ 380,344	287,096	\$ (93,248)	
Less amount paid by the State		(380,344)		
Allowable costs claimed in excess of (less than) amount paid		\$ (93,248)		

Schedule 1 (continued)

<u>Cost Elements</u>	<u>Actual Costs Claimed</u>	<u>Allowable per Audit</u>	<u>Audit Adjustment</u>	<u>Reference ¹</u>
<u>Summary: July 1, 2007, through June 30, 2010</u>				
Direct costs:				
Salaries and benefits	\$ 3,130,314	\$ 3,203,059	\$ 72,745	
Services and supplies	655,795	707,615	51,820	
Total direct costs	3,786,109	3,910,674	124,565	
Indirect costs	1,342,222	1,198,441	(143,781)	
Total direct and indirect costs	5,128,331	5,109,115	(19,216)	
Less authorized health service fees	(4,095,845)	(4,221,525)	(125,680)	
Less offsetting savings/reimbursements	(49,295)	(312,111)	(262,816)	
Total program costs	<u>\$ 983,191</u>	575,479	<u>\$ (407,712)</u>	
Less amount paid by the State		(943,343)		
Allowable costs claimed in excess of (less than) amount paid		<u>\$ (367,864)</u>		

¹ See the Findings and Recommendations section.

Findings and Recommendations

FINDING 1— Understated salaries and benefits

The district understated salaries and benefits for fiscal year (FY) 2007-08 and FY 2008-09. The understated costs total \$72,745.

The district understated salaries and benefits because it did not claim mandate-related costs identified in its High Risk Drinking Prevention Services Program funds, Fund 19427 and Fund 19429.

The following schedule summarizes the audit adjustment:

	Fiscal Year		Total
	2007-08	2008-09	
Salaries and Benefits:			
Fund 19427	\$ 28,754	\$ -	\$ 28,754
Fund 19429	-	43,991	43,991
Audit adjustment	<u>\$ 28,754</u>	<u>\$ 43,991</u>	<u>\$ 72,745</u>

The program's parameters and guidelines state:

To be eligible for mandated cost reimbursement for any fiscal year, only actual costs may be claimed. Actual costs are those costs actually incurred to implement the mandated activities. Actual costs must be traceable and supported by source documents that show the validity of such costs, when they were incurred, and their relationship to the reimbursable activities.

Recommendation

We recommend that the district claim all mandate-related costs that its accounting records and source documents support.

District's Response

For purposes of financial accounting, the District has historically segregated the cost and revenue for this program and other similar programs in separate funds and accounts. For purposes of cost accounting and mandate cost claiming, the District recognizes that there is a choice of either including both the costs and revenue for these types of programs in the annual claim or excluding both the costs and revenues from the annual claim. . . .

The draft audit merges the cost of the Drinking Prevention program with the general student health services program costs in order to avoid the need to identify and segregate the specific scope of the program costs. The District agrees that this is an acceptable method for purposes of mandate cost claiming. The related services and supplies costs for this program are added in at Finding 2. The related program revenues are discussed at Finding 6.

SCO's Comment

The finding and recommendation are unchanged. We disagree with the district's assertion that there is a choice of including or excluding both expenditures and revenues related to the district's High Risk Drinking Prevention Services Program. The activities performed under the High Risk Drinking Prevention Services Program are mandate-related activities. The parameters and guidelines require the district to claim "costs actually incurred to implement the mandated activities." Similarly, the parameters and guidelines require the district to report revenue attributable to the High Risk Drinking Prevention Services Program or other similar programs on its mandated costs claims. The parameters and guidelines state:

Any offsetting savings the claimant experiences as a direct result of this statute must be deducted from costs claimed. In addition, reimbursement for this mandate received from any source, e.g., federal, state, etc., shall be identified and deducted from this claim.

During our audit exit conference conducted on May 7, 2013, we notified the district of the audit adjustment identified in Finding 6 related to offsetting revenue attributable to the High Risk Drinking Prevention Services Program. Subsequent to our exit conference, the district provided documentation of the related expenditures, which are identified in this finding and Finding 2.

**FINDING 2—
Understated services
and supplies**

The district either understated or overstated services and supplies for each fiscal year. For the audit period, the district understated services and supplies by \$51,820. Services and supplies were understated or overstated for the following reasons:

- The district did not provide supporting documentation for claimed costs totaling \$7,312.
- The district claimed unallowable costs for food provided during a disaster drill, a conference, and a self-defense training class. The district also claimed unallowable costs for promotional items including pens, pencils, whistle key light compasses, snack clips, and lollipops. The unallowable costs total \$4,924. Government Code section 17514 states that "costs mandated by the state" means any increased cost that the district is *required* to incur. The costs for food and promotional items are not costs that the district is required to incur to maintain health services at the level provided in the FY 1986-87 base year. Government Code section 17561, subdivision (d)(2)(B), states that the Controller may reduce any excessive or unreasonable claim.
- The district did not claim mandate-related costs identified in its High Risk Drinking Prevention Services Program funds, Fund 19427 and Fund 19429.
- The district did not claim FY 2007-08 mandate-related student insurance costs totaling \$42,931.

The following table summarizes the audit adjustment for services and supplies:

	Fiscal Year			Total
	2007-08	2008-09	2009-10	
Unsupported costs	\$ (1,000)	\$ (2,903)	\$ (3,409)	\$ (7,312)
Food and promotional items	(491)	(2,088)	(2,345)	(4,924)
High Risk Drinking Prevention				
Services Program	2,071	19,054	-	21,125
Student insurance	42,931	-	-	42,931
Audit adjustment	<u>\$ 43,511</u>	<u>\$ 14,063</u>	<u>\$ (5,754)</u>	<u>\$ 51,820</u>

The program's parameters and guidelines state:

. . . Actual costs must be traceable and supported by source documents that show the validity of such costs, when they were incurred, and their relationship to the reimbursable activities. . . .

The claimant is only allowed to claim and be reimbursed for increased costs for reimbursable activities. . . . Increased cost is limited to the cost of an activity that the claimant is required to incur as a result of the mandate. . . .

Recommendation

We recommend that the district claim services and supplies that are supported by its accounting records and source documentation, reimbursable under the mandated program, and required to maintain health services at the level provided in FY 1986-87.

District's Response

A. Unsupported Costs

[N]o additional supporting documentation . . . is available for these costs.

B. Health Services/Promotional Costs

The draft audit report cites Government Code Section 17514 as a reason to disallow the health fair and other costs as not required. This conclusion contradicts the parameters and guidelines which include health fairs as reimbursable activities in Section V. Since the Commission on State Mandates determined that health fair activities are reimbursable, then they are necessary, which invalidates the Controller's reliance upon Section 17514.

The draft audit report also cites Government Code Section 17561 which allows the Controller to audit and reduce any excessive or unreasonable claims. Since the parameters and guidelines allow reimbursement for the health fair and promotional activities, the costs associated with the activity cannot be unreasonable per se. However, the draft audit report concludes that the claimed health fair costs are "not required,"

thus *any* health fair cost would be ostensibly excessive. The conclusion is subjective because the Controller has not cited a published standard for the type and scope of allowable health fair activity costs. The audit report makes no factual claims to support the adjustment on the grounds that the claimed costs were excessive. Absent a fact-based finding that the items purchased were too expensive or some similar finding, there is no basis for the adjustment on the grounds that the claimed costs were excessive.

C. High Risk Drinking Prevention Program

See Finding #1.

D. Student Insurance

The District agrees with this adjustment.

SCO's Comment

The finding and recommendation are unchanged. The district did not provide any additional documentation applicable to the unsupported costs. The district's response and SCO's comment regarding the High Risk Drinking Prevention Services Program are included in Finding 1. The district agreed with the audit adjustment related to student insurance.

The district believes that our audit adjustment related to food and promotional items contradicts the parameters and guidelines. We disagree. Government Code section 17561 states that the SCO may reduce any excessive or unreasonable claim. There is a direct correlation between Government Code sections 17514 and 17561. Although the parameters and guidelines do allow health fairs, the district essentially asserts that any related expense is reimbursable, regardless of necessity or reasonableness.

The parameters and guidelines identify the reimbursable activities of health talks/fairs for the purpose of providing information on sexually transmitted diseases, drugs, AIDS, child abuse, birth control/family planning, and smoking cessation. The district is not required to purchase food or promotional items to complete the activity of providing health information to those who inquire. Therefore, these are not costs that the district is *required* to incur (Government Code section 17514), nor are the costs reasonable (Government Code section 17561).

**FINDING 3—
Overstated indirect
costs**

The district either understated or overstated indirect costs for each fiscal year. For the audit period, the district overstated indirect costs by \$143,781. The district understated or overstated indirect costs for the following reasons:

FY 2007-08

The district calculated separate indirect cost rates for each college. The district calculated the rates in accordance with Office of Management and Budget Circular A-21. However, the parameters and guidelines and the SCO's claiming instructions require that claimants prepare indirect cost rates in accordance with the SCO's FAM-29C methodology.

FY 2008-09

- The district calculated its indirect cost rate using a base of total direct costs. However, the SCO's claiming instructions require the district to use a base of salaries and benefits.
- The district did not allocate direct and indirect costs in accordance with the SCO's claiming instructions.
- The district calculated its indirect cost rate based on actual costs from the preceding fiscal year rather than the current fiscal year.

FY 2009-10

- The district incorrectly identified community relations costs as indirect costs.
- The district calculated its indirect cost rate based on actual costs from the preceding fiscal year rather than the current fiscal year.
- The district calculated indirect costs claimed by applying its indirect cost rate to total direct costs rather than salaries and benefits.

For each fiscal year, we calculated allowable indirect cost rates using the SCO's FAM-29C methodology and actual costs from the current fiscal year.

The following table summarizes the audit adjustment:

	Fiscal Year			Total
	2007-08	2008-09	2009-10	
Allowable salaries and benefits	\$ 985,511	\$ 1,065,543	\$ 1,152,005	
Allowable indirect cost rate	x 35.55%	x 37.99%	x 38.48%	
Allowable indirect costs	350,349	404,800	443,292	
Indirect costs claimed	(337,854)	(459,669)	(544,699)	
Audit adjustment	\$ 12,495	\$ (54,869)	\$ (101,407)	\$ (143,781)

The parameters and guidelines state, “Indirect costs may be claimed in the manner described by the State Controller in his claiming instructions.”

For all fiscal years, the SCO’s claiming instructions allow the district to claim indirect costs using the SCO’s FAM-29C methodology. The claiming instructions identify the allocation of direct and indirect costs, and specify that the FAM-29C methodology uses a direct cost base of salaries and benefits.

Recommendation

We recommend that the district claim indirect costs using indirect cost rates computed in accordance with the FAM-29C methodology specified in the SCO’s claiming instructions.

District’s Response

For FY 2007-08, the District continued its previous practice of using separate federally approved indirect cost rates for each college, rather than use the Controller’s FAM-29C methodology. . . .

Beginning FY 2008-09, the District used the Controller’s FAM-29C form that utilizes the state mandated CCSF-311 annual report to the Chancellor’s Office. The FAM-29C method requires depreciation information from the claimant’s annual audited financial statements to be added to the CCSF-311 information to prepare the calculation. Since the audited depreciation [*sic*] expense information is usually not available at the time the annual claims were prepared, the District used prior year CCFS-311 reports and prior year depreciation expense information. . . .

There were other differences in how the District utilized the FAM-29C method. For FY 2008-09, the District calculated its indirect cost rate using a cost base of total direct costs rather than use a base of salaries and benefits, only. The District also applied the indirect cost rate to total direct costs, rather than just salary and benefits. These choices were disallowed by the audit based on Controller policy changes over a period of years. The overall differences in the reported and audited indirect rates for these two years are not significant considering all of the variables involved.

There is no legal requirement to use the FAM-29C method The Controller’s claiming instructions were never adopted as rules or regulations and have no force of law, so adjustments based on the claiming instructions as “rules” are not enforceable. The parameters and guidelines for the Health Fee Elimination program (as amended on May 25, 1989), which are the legally enforceable standards for claiming costs, state that: “Indirect costs *may be claimed* in the manner described by the Controller in his claiming instructions” (emphasis added). Therefore, the parameters and guidelines *do not require* that indirect costs be claimed in the manner described by the Controller. Instead, the burden is on the Controller to show that the indirect cost method or allocations used by the District are excessive or unreasonable, which is the only mandated cost audit standard in statute (Government Code Section 17651(d)(2)). The District’s choice of indirect cost rate calculation methods is reasonable and are [*sic*] not contrary to the parameters and guidelines.

SCO's Comment

The finding and recommendation are unchanged. Our comments are as follows:

- The district acknowledges that it claimed indirect costs for FY 2007-08 by using separate indirect cost rates for each of the district's colleges. The indirect cost rates claimed were derived from a federally-approved rate. However, the parameters and guidelines and the SCO's claiming instructions require the district to calculate an indirect cost rate in accordance with the SCO's FAM-29C methodology.
- The district states that current year CCFS-311 and audited financial statements are "usually not available at the time the annual claims were prepared." We disagree. The phrase "at the time the annual claims were prepared" is vague and not relevant. The district's CCFS-311 and audited financial statements were available well before the mandated cost claim due dates. The table below shows the claim due dates pursuant to Government Code section 17560, and the dates of the district's CCFS-311 reports and audited financial statements:

Fiscal Year	Claim Due Date	CCFS-311	Financial Statements
2007-08	February 15, 2009	October 16, 2008	December 2, 2008
2008-09	February 15, 2010	September 24, 2009	December 3, 2009
2009-10	February 15, 2011	October 18, 2010	December 7, 2010

- The district states that its FY 2008-09 "choices" on implementing the SCO's FAM-29 methodology were disallowed based on SCO "policy." The SCO's FAM-29C methodology does not provide choices, nor did we identify an audit adjustment based on policy. The parameters and guidelines require the district to calculate its indirect cost rate in accordance with the SCO's claiming instructions. The SCO's claiming instructions from FY 2007-08 forward identify the direct cost base as salaries and benefits. There was no retroactive application of the specified direct cost base.
- The district identified the claimed and audited indirect cost rates and opined that the differences between the rates "are not significant considering all of the variables involved." We disagree. We noted that the district:
 - Provided no specificity regarding its reference to "all of the variables involved." There are no variables involved in calculating an indirect cost rate in accordance with the SCO's claiming instructions.

- Did not recognize that a comparison of the FY 2008-09 claimed and audited rates is irrelevant. The district acknowledges that it calculated its claimed indirect cost rate using a base of total direct costs. However, we calculated the audited indirect cost rate using a direct cost base of salaries and benefits. Therefore, the claimed and audited rates are not homogeneous for comparison.
 - Failed to acknowledge that just the 0.6% difference between the FY 2009-10 claimed and audited indirect cost rates results in unallowable costs totaling \$6,912. The remaining audit adjustment resulted from the district's incorrect application of the indirect cost rate to total direct costs rather than salaries and benefits.
- The district cites parameters and guidelines dated May 25, 1989, which do not apply to the audit period. The parameters and guidelines amended January 29, 2010, are effective for FY 2005-06 forward. The claim preparation instructions are consistent between the two versions for indirect costs. We disagree with the district's interpretation of the parameters and guidelines. The phrase "may be claimed" permits the district to claim indirect costs. However, if the district claims indirect costs, then the parameters and guidelines require that it comply with the SCO's claiming instructions.
- The district asserts that Government Code section 17561, subdivision (d)(2), which allows the SCO to reduce any claim that it determines is excessive or unreasonable, is "the only mandated cost audit standard in statute." We disagree. Government Code section 17561, subdivision (d)(2), allows the SCO to audit the district's records to verify actual mandate-related costs *and* reduce any claim that the SCO determines is excessive or unreasonable. In addition, Government Code section 12410 states, "The Controller shall audit all claims against the state, and may audit the disbursement of any state money for correctness, legality, and for sufficient provisions of law for payment."

**FINDING 4—
Offsetting
savings/reimbursements
incorrectly reported as
authorized health
service fees**

The district incorrectly reported offsetting savings/reimbursements totaling \$158,499 as authorized health service fees. The offsetting savings/reimbursements included self-supported program revenue that the district identified in Account 14000.

A district representative confirmed that self-supported program revenue was attributable to fees charged to students for various health services rendered. The self-supported program revenue was separate from the authorized health service fee assessed pursuant to Education Code section 76355. We identified the self-supported program revenue as understated offsetting savings/reimbursements in Finding 5.

The following table summarizes the audit adjustment and the adjusted authorized health services claimed:

	Org. Number	Fund Number	Fiscal Year		Total
			2007-08	2008-09	
Self-supported program revenue	2520	14000	\$ 38,416	\$ 14,927	\$ 53,343
Self-supported program revenue	5565	14000	66,515	38,641	105,156
Audit adjustment, authorized health service fees			104,931	53,568	\$ 158,499
Authorized health service fees claimed			(1,228,620)	(1,358,360)	
Adjusted authorized health service fees claimed			\$ (1,123,689)	\$ (1,304,792)	

The parameters and guidelines state:

Any offsetting savings the claimant experiences as a direct result of this statute must be deducted from the costs claimed. In addition, reimbursement for this mandate received from any source, e.g., federal, state, etc., shall be identified and deducted from this claim.

The SCO's claiming instructions direct claimants to report authorized health service fees and other reimbursements separately.

Recommendation

We recommend that the district properly claim revenue as offsetting savings/reimbursements when the revenue is unrelated to the student health fee authorized by Education Code section 76355.

District's Response

This finding is essentially a reclassification of service fee revenues
The District concurs that these service fees are revenues separate from the student health service semester fees. . . .

SCO's Comment

The finding and recommendation are unchanged. The district concurred with the reclassification.

**FINDING 5—
Understated
authorized health
service fees**

The district either understated or overstated authorized health service fees for each fiscal year. For the audit period, the district understated its authorized health service fees by \$284,179.

The district understated these fees because it reported actual receipts rather than authorized fees for FY 2007-08 and FY 2008-09. We also noted that the district did not charge all students the full authorized fee amount for summer session, fall semester, and spring semester for those two fiscal years. For FY 2009-10, the district calculated its authorized health service fees using student enrollment data that did not agree with data that the district submitted to the California Community Colleges Chancellor's Office (CCCCO).

Mandated costs do not include costs that are reimbursable from authorized health service fees. Government Code section 17514 states that "costs mandated by the state" means any increased costs that a school district is required to incur. To the extent community college districts can charge a fee, they are not *required* to incur a cost. In addition, Government Code section 17556 states that the Commission on State Mandates shall not find costs mandated by the State if the school district has the authority to levy fees to pay for the mandated program or increased level of service.

Education Code section 76355, subdivision (c), states that health fees are authorized for all students except those who: (1) depend exclusively on prayer for healing; or (2) are attending a community college under an approved apprenticeship training program.

The CCCCCO identified the fees authorized by Education Code section 76355, subdivision (a). The following table summarizes the authorized fees:

Fiscal Year	Authorized Health Fee Rate	
	Summer Session	Fall and Spring Semesters
2007-08	\$13	\$16
2008-09	\$14	\$17
2009-10	\$14	\$17

We obtained the applicable student enrollment data from the CCCCCO. The CCCCCO identified enrollment data from its Management Information System (MIS) based on student data that the district reported. The CCCCCO identified the district's enrollment based on MIS data element STD7, codes A through G. The CCCCCO eliminated any duplicate students based on their social security numbers. CCCCCO data element and code definitions are available at <http://www.cccco.edu/SystemOffice/Divisions/TechResearchInfo/MIS/DED/tabid/266/Default.aspx>. The district did not identify any students that it excluded from the health service fee pursuant to Education Code section 76355, subdivision (c)(1).

The following table shows the authorized health service fee calculation and audit adjustment:

	Summer Session	Fall Semester	Spring Semester	Total
<u>Fiscal Year 2007-08</u>				
Number of enrolled students	14,898	34,750	33,711	
Authorized health fee rate	x \$(13)	x \$(16)	x \$(16)	
Authorized health service fees	<u>\$ (193,674)</u>	<u>\$ (556,000)</u>	<u>\$ (539,376)</u>	\$ (1,289,050)
Less adjusted authorized health service fees claimed (Finding 3)				<u>1,123,689</u>
Audit adjustment, FY 2007-08				<u>(165,361)</u>
<u>Fiscal Year 2008-09</u>				
Number of enrolled students	16,285	36,792	34,357	
Authorized health fee rate	x \$(14)	x \$(17)	x \$(17)	
Authorized health service fees	<u>\$ (227,990)</u>	<u>\$ (625,464)</u>	<u>\$ (584,069)</u>	(1,437,523)
Less adjusted authorized health service fees claimed (Finding 3)				<u>1,304,792</u>
Audit adjustment, FY 2008-09				<u>(132,731)</u>
<u>Fiscal Year 2009-10</u>				
Number of enrolled students	14,601	38,398	37,516	
Authorized health fee rate	x \$(14)	x \$(17)	x \$(17)	
Authorized health service fees	<u>\$ (204,414)</u>	<u>\$ (652,766)</u>	<u>\$ (637,772)</u>	(1,494,952)
Less authorized health service fees claimed				<u>1,508,865</u>
Audit adjustment, FY 2009-10				<u>13,913</u>
Total audit adjustment				<u>\$ (284,179)</u>

Recommendation

We recommend that the district:

- Deduct authorized health service fees from mandate-related costs claimed. To properly calculate authorized health service fees, we recommend that the district identify the number of enrolled students based on MIS data element STD7, codes A through G.
- Maintain documentation that identifies the number of student excluded from the health service fee based on Education Code section 76355, subdivision (c)(1).
- Charge students the authorized fee amount for each school term.

District's Response

The district did not dispute the audit adjustment.

**FINDING 6—
Understated offsetting
savings/reimbursements**

The district understated offsetting savings/reimbursements by \$262,816 because of the following reasons:

- The district did not claim self-supported program revenue totaling \$158,499. The self-supported program revenue consisted of money collected from students for health center services such as laboratory tests, immunizations, medications, exams, and other services. This revenue is separate from the health service fee assessed to students.
- The district did not claim offsetting savings/reimbursements identified in its High Risk Drinking Prevention Services Program funds, Fund 19427 and Fund 19429.

The following table summarizes the audit adjustment:

	Org. No.	Fund No.	Fiscal Year		Total
			2007-08	2008-09	
Self-supported program revenue	2520	14000	\$ (38,416)	\$ (14,927)	\$ (53,343)
Self-supported program revenue	5565	14000	(66,515)	(38,641)	(105,156)
High Risk Drinking Prevention Services Program	5565	19427	(31,817)	-	(31,817)
High Risk Drinking Prevention Services Program	5565	19429	-	(72,500)	(72,500)
Audit adjustment			<u>\$ (136,748)</u>	<u>\$ (126,068)</u>	<u>\$ (262,816)</u>

The parameters and guidelines state:

Any offsetting savings the claimant experiences as a direct result of this statute must be deducted from the costs claimed. In addition, reimbursement for this mandate received from any source, e.g., federal, state, etc., shall be identified and deducted from this claim.

Recommendation

We recommend that the district report all mandate-related offsetting savings/reimbursements on its mandated cost claims.

District's Response

The district did not dispute the audit adjustment.

**OTHER ISSUE—
Public records request**

The district's response included a public records request. The district's response and SCO's comment are as follows:

District's Response

The District requests that the Controller provide the District any and all written instructions, memorandums, or other writings in effect and applicable during the claiming period to Finding 2 (regarding student health fair and promotional expenditures) and Finding 3 (indirect cost rate calculation standards).

SCO's Comment

The SCO provided the district the requested records by separate letter dated July 5, 2013.

**Attachment—
District's Response to
Draft Audit Report**



NORTH ORANGE COUNTY
COMMUNITY COLLEGE DISTRICT

Send CERTIFIED MAIL - RETURN RECEIPT REQUESTED

FRED WILLIAMS
Vice Chancellor
Finance & Facilities

NED DOFFONEY, Ed.D.
Chancellor

June 18, 2013

Mr. Jim L. Spano, Chief
Mandated Costs Audits Bureau
Division of Audits
California State Controller
P.O. Box 942850
Sacramento, CA 94250-5874

Re: Health Fee Elimination State Mandate Program
Annual Claim Fiscal Years: 2007-08, 2008-09, and 2009-10
North Orange County Community College District

Dear Mr. Spano:

This letter is the response of the North Orange County Community College District to the draft audit report dated May 29, 2013, and received June 4, 2013, for the above referenced program and fiscal years transmitted by the letter from Jeffrey V. Brownfield, Chief, Division of Audits, State Controller's Office.

Finding 1 Understated salaries and benefits

The draft audit report states that the District understated its student health services salary and benefit costs for FY 2007-08 and FY 2008-09 in the total amount of \$72,745 because the District did not include the costs for the High Risk Drinking Prevention Services Program with the general student health services program costs.

For purposes of financial accounting, the District has historically segregated the cost and revenue for this program and other similar programs in separate funds and accounts. For purposes of cost accounting and mandate cost claiming, the District recognizes that there is a choice of either including both the costs and revenue for these types of programs in the annual claim or excluding both the costs and revenues from the annual claim. That choice is usually determined by the utility of identifying all of the costs associated

with the program and the separation of those specific costs from the other student health services program costs in order to later match those costs to specific program revenues.

The draft audit merges the cost of the Drinking Prevention program with the general student health services program costs in order to avoid the need to identify and segregate the specific scope of the program costs. The District agrees that this is an acceptable method for purposes of mandate cost claiming. The related services and supplies costs for this program are added in at Finding 2. The related program revenues are discussed at Finding 6.

Finding 2 Understated services and supplies

The draft audit report concludes that the District either understated or overstated services and supplies with a net understatement of \$51,820, for the following reasons:

A. Unsupported Costs <\$7,312>

The draft audit report states that the District did not provide supporting documentation for claimed costs totaling \$7,312. The total amount identified for this part for the adjustment comprises four items:

2007-08	Move to appropriate account	\$1,000
2008-09	TC/CC Health center exp from	\$2,903
2009-10	Glaxo Smith	\$2,775
2009-10	Positive Promotions	<u>\$ 634</u>
	Total	\$7,312

The first impression from this adjustment is that the District documentation retention process must be generally satisfactory considering that there are only four items without "support," especially since these expenses were incurred and paid as much as five years ago. However, no additional supporting documentation that meets the Controller's audit standards is available for these costs.

B. Health Services/Promotional Costs <\$4,924>

The draft audit asserts that \$4,924 incurred by the District to purchase food and promotional items for the student health fair and other student events are unallowable costs because these are

not expenditures the District is required to make in order to maintain the base-year level of health services. The draft audit report cites Government Code Section 17514 as a reason to disallow the health fair and other costs as not required. This conclusion contradicts the parameters and guidelines which include health fairs as reimbursable activities in Section V. Since the Commission on State Mandates determined that health fair activities are reimbursable, then they are necessary, which invalidates the Controller's reliance upon Section 17514.

The draft audit report also cites Government Code Section 17561 which allows the Controller to audit and reduce any excessive or unreasonable claims. Since the parameters and guidelines allow reimbursement for the health fair and promotional activities, the costs associated with the activity cannot be unreasonable per se. However, the draft audit report concludes that the claimed health fair costs are "not required," thus *any* health fair cost would be ostensibly excessive. The conclusion is subjective because the Controller has not cited a published standard for the type and scope of allowable health fair activity costs. The audit report makes no factual claims to support the adjustment on the grounds that the claimed costs were excessive. Absent a fact-based finding that the items purchased were too expensive or some similar finding, there is no basis for the adjustment on the grounds that the claimed costs were excessive.

Because there is no legal question that these student events are appropriate, and no indication that the costs were excessive, the District requests that the adjustments be withdrawn.

C. High Risk Drinking Prevention Program Increase
 \$21,125

See Finding #1

D. Student Insurance Increase \$42,931

The District agrees with this adjustment. For FY 2007-08, the allowable portion of the student health insurance premium amount was not transferred into the student health services account, as was the case for other fiscal years. This amount should have been included in the claim.

Finding 3 - Overstated indirect costs

The draft audit report states that the District either understated or overstated indirect costs by a net amount of \$143,781 for the three fiscal years included in the audit.

<u>Fiscal Year</u>	<u>Claimed Rates</u>		<u>District</u>	<u>Audited Percentage</u>	<u>Difference</u>
	<u>Fullerton</u>	<u>Cypress</u>			
2007-08 District method: Federal rate	29.50%	29.15%		35.55%	+ 6.05-6.40
2008-09 District Method: FAM 29C w/ depreciation expense			37.04	37.99%	+0.95%
2009-10 District Method: FAM 29C w/ depreciation expense			39.08%	38.48%	<0.60%>

For FY 2007-08, the District continued its previous practice of using separate federally approved indirect cost rates for each college, rather than use the Controller's FAM-29C methodology which calculates one indirect cost rate for the entire district. The Controller allowed districts to use the federal rate until a change in policy for audits conducted on annual claims beginning FY 2004-05.

Beginning FY 2008-09, the District used the Controller's FAM-29C form that utilizes the state mandated CCSF-311 annual report to the Chancellor's Office. The FAM-29C method requires depreciation information from the claimant's annual audited financial statements to be added to the CCSF-311 information to prepare the calculation. Since the audited depreciation expense information is usually not available at the time the annual claims were prepared, the District used prior year CCFS-311 reports and prior year depreciation expense information. This is a consistent practice that does not result in any significant difference in reimbursement over the long term.

There were other differences in how the District utilized the FAM-29C method. For FY 2008-09, the District calculated its indirect cost rate using a cost base of total direct costs rather than use a base of salaries and benefits, only. The District also applied the indirect cost rate to total direct costs, rather than just salary and benefits. These choices were disallowed by the audit based on Controller policy changes over a period of years. The overall differences in the reported and audited indirect rates for these two years are not significant considering all of the variables involved.

There is no legal requirement to use the FAM-29C method and until recent years many districts used federal rates without adjustment. The Controller's claiming instructions were never adopted as rules or regulations and have no force of law, so adjustments based on the claiming instructions as "rules" are not enforceable. The parameters and guidelines for the Health Fee Elimination program (as amended on May 25, 1989), which are the legally enforceable standards for claiming costs, state that: "Indirect costs *may be claimed* in the manner described by the Controller in his claiming instructions" (emphasis added). Therefore, the parameters and guidelines *do not require* that indirect costs be claimed in the manner described by the Controller. Instead, the burden is on the Controller to show that the indirect cost method or allocations used by the District are excessive or unreasonable, which is the only mandated cost audit standard in statute (Government Code Section 17651(d)(2)). The District's choice of indirect cost rate calculation methods is reasonable and are not contrary to the parameters and guidelines.

Finding 4 Offsetting savings/reimbursements incorrectly reported as authorized health service fees

This finding is essentially a reclassification of service fee revenues. The audit report states that for FY2007-08 and FY 2008-09 the District incorrectly reported clinical, laboratory, and other service fees (Fund 14000) totaling \$158,499 as authorized student health service semester fees. The District concurs that these service fees are revenues separate from the student health service semester fees for purposes of the calculation of authorized collectible student health service semester fees as required by the *Clovis* court decision. See Finding 5.

Finding 5 - Understated authorized health service fees

The draft audit report states that "authorized" student health service fee revenues were understated by a net amount of \$284,179 for the audit period. The magnitude of the adjustment is due to the fact that the District, as did many other districts, reported for FY 2007-08 and FY 2008-09 the actual student health service fees of all types (including the fees identified in Finding 4) that it collected rather than the amount "authorized" student health service fees that could have been collected. The Controller calculates "authorized" student health service fee revenues, that is, the student health service fees collectible, based on the highest student health service fee chargeable, rather than the full-time or part-time student health service fee actually charged to the student

and actually collected. Districts can, and many do, charge less than the full amount allowed by the Education Code.

This legal issue of actual revenue versus collectible fees persists from prior District audits. It was the subject of an ongoing statewide dispute and litigation. However, the *Clovis* Appellate Court decision in September 2010 determined that it was and is appropriate for the Controller to calculate the collectible student health service fees by imputing the highest fee chargeable to all nonexempt students, full or part-time, and at all instructional locations. This District began complying with the court decision the next time an annual claim was filed. Since the court case also applies retroactively, it also applies for these audit years.

The other source of the adjustment is the factual matter of the student enrollment statistics. The Controller utilized the Chancellor's Office MIS data, as does the District, with some minor variances. This issue was also the subject of an ongoing statewide dispute. However, on October 27, 2011, the Commission on State Mandates decided seven Health Fee Elimination incorrect reduction claims which included this issue and determined that, in the absence of claimant evidence to the contrary, the Chancellor's MIS data is the preferred source of enrollment statistics. The District has no such information to the contrary. The District does not dispute this administrative law finding and has complied with the Commission decision in future annual claims.

Finding 6 Understated offsetting savings/reimbursements

The audit report states that the District understated offsetting savings/ reimbursements by \$262,816 for two reasons:

Self-supported Program Revenue (Fund 14000)

This is a reclassification of the clinical service fees revenue totaling \$158,499, for FY 2007-08 and FY 2008-09, identified in Finding 4, and for the reasons explained in Finding 5.

High Risk Drinking Prevention Services

This adjustment matches the \$104,317 of High Risk Drinking Prevention Services Fund grant revenues to the costs identified in Finding 1, for FY 2007-08 and FY 2008-09.

These adjustments appropriately segregate service fees and program revenues from the student health services semester fee revenue for the purposes of calculating the authorized student health services semester fee revenue as required by the *Clovis* court decision.

Public Records Request

The District requests that the Controller provide the District any and all written instructions, memorandums, or other writings in effect and applicable during the claiming period to Finding 2 (regarding student health fair and promotional expenditures) and Finding 3 (indirect cost rate calculation standards).

Government Code section 6253, subdivision c, requires the state agency that is the subject of the request, within ten days from receipt of a request for a copy of records, to determine whether the request, in whole or in part, seeks copies of disclosable public records in possession of the agency and promptly notify the requesting party of that determination and the reasons therefor. Also, as required when so notifying the District, the agency must state the estimated date and time when the records will be made available.

Sincerely,



Fred Williams, Vice Chancellor, Finance and Facilities
North Orange County Community College District

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

<http://www.sco.ca.gov>